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SUBJECT: MEETING WITH BANK REGULATORY BOARD CHAIRMAN

REF: ANKARA 3412

1. (Sbu) Summary: Bank Regulatory Board (BRSA) Chairman Tevfik Bilgin told econcouns June 14 that his priority is preparation for the lifting of the blanket guarantee on deposits July 5, specifically monitoring to ensure there is no flight of deposits from private to state-owned banks. Bilgin revealed that coordination between newly-separated SDIF and BRSA is not working smoothly. He implied that the Cukurova group had worked out a tentative deal to restructure its debt payments to the Deposit Guarantee Fund (SDIF) but that the SDIF and BRSA boards would have to approve. He explained that the deal would build in incentives for Cukurova to sell its Yapi Kredi shares quickly. End Summary.

Lifting the Blanket Guarantee on Deposits:

2. (Sbu) In a June 14 farewell call by Econcouns, Bilgin said his priority is to be sure the banking sector is ready for the lifting of the blanket guarantee on deposits July 5. Note: The lifting of the blanket guarantee is a long-awaited reform, designed to reduce the moral hazard of the state's unlimited guarantee on deposits, limiting it to TL 50 billion (about \$33,000) per account. End Note. Bilgin claimed the sector was ready but required careful vigilance by regulators, as banks--especially the smaller private banks--need to be ready for a possible flight to quality. The regulators are therefore urging these small banks to strengthen their liquidity positions, which of course, cuts into their profits. Given the risk of flight from private to state-owned banks arising from the implied state guarantee inherent in the state ownership, Bilgin said state banks are keeping their deposit rates lower than private banks. Note: As reported earlier, under the IFI-agreed state bank privatization strategy, the state banks are supposed to keep their deposit rates no higher than private banks' rates on a risk-adjusted basis. End Note. Bilgin said that the state banks need to be ready to further lower their deposit rates, if needed.

Banking Law:

3. (Sbu) Bilgin revealed that the new banking law, in the end, did not prohibit owners of banks from also owning foundations or media outlets. Bilgin explained that the BRSA had asked other OECD countries about their practices, and found that none had these kinds of prohibitions in their banking laws, though some had similar bans in their press laws. Bilgin said the key is good supervision, which the banking law addresses. Among other features, he cited the end of the sworn auditor's monopoly of on-site inspection, to allow IT experts, for example, to join these inspections. He agreed that allowing IT experts to join on-site audits was a result of the on-site inspectors' failure to catch Imar Bank's use of fraudulent systems. Bilgin confirmed that passage of the Banking Law would be delayed until September or October.

BRSA-SDIF Coordination:

4. (Sbu) When asked about how BRSA-SDIF coordination is working now that the two boards are separate and SDIF has moved to Istanbul, Bilgin revealed that it is not going well. Without going into detail, his expression and body language suggested the coordination was far from smooth. Note: One of the key components in the banking law, required under the GOT's IMF and World Bank programs, was for the law to spell out in detail the respective roles and responsibilities and coordination mechanisms for SDIF and BRSA. End note.

Cukurova Deal:

5. (Sbu) On June 4 press reports of agreement between regulators and Cukurova on a long-rumored deal were

subsequently denied by SDIF and BRSA. The Capital Markets Board subsequently launched an investigation of possible market manipulation. Bilgin said he believes the first report was a deliberate move by speculators in Yapi Kredi stock. As for the status of regulators' discussions with Cukurova, Bilgin said any deal would still have to be approved by the SDIF board and then by the BRSA board. Since Bilgin then went into some detail about the structure of a possible deal, he seemed to imply that negotiations were at an advanced stage. Mentioning that the deal would reduce the maturity of Cukurova's payment plan from 15 years to two years, Bilgin said the key issue for the SDIF board was the Net Present Value (NPV) of the deal and the interest rate used for the NPV calculation. Note: The NPV is important because Cukurova should not be getting a better NPV than previously-agreed to. End Note. Bilgin, who rejected an earlier deal with Cukurova in January, said the key issue for BRSA is that Cukurova and its owner, Mehmet Karamehmet, not be allowed back into the banking sector.

16. (Sbu) According to Bilgin, the tentative deal would not allow Cukurova back into banking, but would build in incentives for it to find a buyer for Yapi Kredi Bank as quickly as possible. He said it was important to resolve the issue because Yapi Kredi represents 10 percent of the banking sector (and Bilgin had earlier admitted that the uncertainty created by the situation with Cukurova was eroding Yapi Kredi's value). Note: Cukurova group companies currently own 40.7 percent of Yapi Kredi's shares, with another 12.9 percent, formerly held by the intervened Pamuk Bank, now held by SDIF. 41.6 percent are quoted on the Istanbul Stock Exchange. End Note. Bilgin also admitted he was anxious to solve this before the lifting of the blanket deposit guarantee July 5.

17. (Sbu) According to Bilgin, the incentive for Cukurova to find a buyer for its Yapi Kredi shares was that, if anything happens to Yapi Kredi, Cukurova would be exposed to the December 2003 law enabling SDIF to go after assets of owners of failed banks and their families--the law that SDIF used to seize all Uzan group companies earlier this year. SDIF, after seizing the Turkcell shares, could go after Cukurova group--and Karamehmet family--assets, because the Turkcell shares were not of sufficient value to cover all of Cukurova's liabilities to Yapi Kredi. Under the tentative deal, Bilgin said the Turkcell shares would be released in proportion to the loan payments by Cukurova, however, for each monthly \$100 million-odd payment only about 70% of this amount in Turkcell shares would be released. Bilgin said this would keep the pressure on Cukurova to sell its Yapi Kredi shares.

18. (Sbu) Another issue that BRSA will have to closely scrutinize, according to Bilgin, is the source of Cukurova's financing of the accelerated payments. In the earlier deal Bilgin rejected, Cukurova had floated a plan to finance the deal from a mysterious offshore company called North Petroleum. Now, Bilgin said the financing source is still not clear. He hopes the money will come through Citigroup and HSBC, because that would provide some confidence that these banks and their home country regulators will be applying a high standard of anti-money laundering practices.

Demir and Kent Bank Cases:

19. (Sbu) Bilgin continues to worry about the potential ramifications of the court decision in favor of the former owners of Demir and Kent Banks. BRSA has now received the text of the court's decision which tracks with its earlier decision, i.e. that the Central Bank effectively caused the failure by cutting its lines of credit to Demir, and that the BRSA should have given Kent Bank's owners more time to bring the bank's capital up to required levels. Bilgin noted former Kent owner Mustafa Suzer's comments to the press about wanting his bank back. As he had said at an earlier meeting, Bilgin said he fears that a BRSA rejection, if Suzer applies for a license, would be overturned by the courts.

EDELMAN